

General Information Letter: Internet seller with employee working in Illinois is not protected from Illinois income taxation by the Internet Tax Freedom Act.

May 24, 1999

Dear:

This is in response to your letter dated May 4, 1999. Given the nature of your inquiry and the information you provide, I am responding with a General Information Letter. This is not to be taken as a statement of Department policy or as a binding ruling by the Department. As general information gathered in response to your particular questions, however, I hope that it is helpful to you. See 86 Ill. Adm. Code 1200.120(b) and (c).

In your letter you have stated the following:

Good Morning. xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx requests determination of nexus with the State of Illinois for the purpose of collecting and paying sales and use tax, franchise and income taxes and any other taxes for which we would be responsible. Following is an overview of our company structure, business activities and duties of the employee we have resident in the State.

xx (was) incorporated in the State of North Carolina March 19, 1999. We are an internet based company in the business of selling books and software via the internet, representing several small presses and a software developer as marketing representatives; and developing software packages to market to small publishers. We have no brick and mortar storefronts, leased or owned office space, inventory or other property in the State of Illinois or any other State. The four principals of the Company live in four different States and telecommute from their homes to work via the internet.

Our employee in the State of Illinois is our webmaster and software developer. His duties are to maintain our website, xxxxxxxxxxxxxxxxxxxxxxxxxxxx, and develop software for internal use and to be marketed to the public. He has no specific or general duties which require him to be in the State, makes no sales contacts on behalf of the Company nor does any work within the State that in any way enhances sales to Illinois residents. He is not located in the State for the convenience of the Company and is not required to live or work within the State. No employee of xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx is required to live in any specific geographic area. Our only residency requirement for all our employees is that they live where they will have reliable access to the internet.

A recent telephone conversation with an employee of the Department of Revenue revealed that the IDOR does consider us to have nexus based upon the residency of our employee, who works from his home. Our employees appear to meet the specific test of "substantial nexus" established by judicial precedent and prior interpretations of the Commerce Clause of the United States Constitution specifically *Quill v. North Dakota*, 112 S. Ct. 1904 and the earlier decision upon which it was based, *Standard Steel Co. v. Washington Revenue Dept.*, 419 U.S. 560. However, we feel that since our company is internet-based and these precedents and interpretations did not

address or take internet telecommuting into consideration that they should not apply. In those decisions, the physical presence of the employees directly benefited the companies in conducting business within the States. This reason for physical presence does not exist within our Company.

The Internet Tax Freedom Act (PL 105-277) does uphold the "bright-line" physical presence test established by the above cases. However, Section 1101(a) states:

(a) Moratorium. -- No State or subdivision thereof shall impose any of the following taxes during the period beginning on October 1, 1998 and ending 3 years after the date of the enactment of this Act--

- (1) taxes on Internet access, unless such tax was generally imposed and actually enforced prior to October 1, 1998; and
- (2) multiple or discriminatory taxes on electronic commerce.

Additionally, Section 1104(2) sets the following definitions of discriminatory taxes:

Discriminatory tax. -- The term "discriminatory tax" means --

- (A) any tax imposed by a State or political subdivision thereof on electronic commerce that--
 - (i) is not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means;
 - (ii) is not generally imposed and legally collectible at the same rate by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means, unless the rate is lower as part of a phase-out of the tax over not more than a 5-year period;
 - (iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means; . . . (remainder omitted)

NOTE: The full text of the Internet Tax Freedom Act is available on the internet at: <http://www.house.gov/chriscox/nettax/>. This is on the website of Representative Christopher Cox of California.

Were it not for the ability of our employees to telecommute to work via the internet we could not have an employee in Illinois and therefore could not conduct business in your State through other means.

For this reason we believe taxing an internet-based company whose employees telecommute to work via the internet, whose employees are not located within the State specifically for the purpose of conducting work for the Company or for the convenience of the Company and could not live and work in the State

were the internet not available, is discriminatory in nature and prohibited by the Internet Tax Freedom Act.

Until such time as we receive a letter of nexus determination from IDOR on this request we will collect sales tax on any sales we may have to Illinois residents and maintain proper accounting records for payment of income and franchise taxes but it is to be understood they are being collected and remitted under protest.

We ask that you make a decision on this matter as expeditiously as possible. Thank you.

Response

The Illinois Department of Revenue does not provide prospective determinations of nexus for multi-state businesses. A judgment on nexus is made only in the context of an audit, where relevant facts and circumstances can be gathered to the satisfaction of a revenue official. In anticipation of that eventuality, the taxpayer is expected to adhere to current principles of law.

With respect to the law, your explanation of the impact of the *Quill* decision on Due Process and Commerce Clause jurisprudence is accurate. The presence of a single full-time employee working in a State would generally establish nexus under that standard and all earlier Supreme Court standards, as well.

You also argue that taxation of this business in Illinois would be considered discriminatory under the Internet Tax Freedom Act, because the single employee is neither required to work in Illinois nor is working in Illinois at the convenience of the Company, but is able to work in Illinois only because he does so by telecommuting through the internet. This is a question not yet addressed in Illinois, either administratively or in the courts, but a close reading of the federal legislation does not seem to support your argument. Any taxpayer with an employee working in this State, regardless of the reason or lack of reason therefor, would be subject to Illinois taxation. What, in fact, you are asking is that Illinois discriminate *in favor* of your company, solely because it operates through the internet. We do not believe that the federal statute reaches that far.

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Sincerely,

Kent R. Steinkamp
Staff Attorney -- Income Tax